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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
Appellant,

vs.

NEBRASKA STATE RAILWAY COMMISSION,
Appellee.

APPEAL FROM THE SUPREME COURT OF THE STATE OF NEBRASKA

BRIEF IN ANSWER TO BRIEF OF NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

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BRIEF IN ANSWER TO BRIEF OF NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

THE FEDERAL GOVERNMENT HAS POWER TO REGULATE AND HAS REGULATED THE ACCOUNTING OF APPELLANT TO THE EXCLUSION OF ANY STATE REGULATION THEREOF.

The first point sought to be made on behalf of the National Association is:

> "Reports of public service companies to state governments, and accounts prescribed by state law to enable such reports to be made, are means and instrumentalities of state government not subject to destruction by Congress."

If we correctly understand this contention, it is that the bookkeeping of carriers engaged in interstate commerce is a "means and instrumentality" of state government, and no federal regulation thereof is valid if in-

consistent with the requirements of state law. This statement seems at once to be so far in conflict with principles which are not open to question as to suggest re-examination to the end of being certain that it is properly understood.

Interstate carriers, like all other substantial enterprises, must keep books of account. The manifold activities of government make such accounting records of obvious public concern in many respects. No doubt, such accounts are of concern to both state and federal authority. No elaboration is required to establish this as respects a common carrier, organized under state law, engaged in both interstate and intrastate commerce and owning property in various states.

It must be noticed that the attack upon the order in suit is with reference to what it requires of appellant as to its *accounts,* and not what it requires as to its *reports* to the Nebraska Commission. This very proceeding before that body is sufficient to illustrate the readiness of appellant to furnish information in its possession to the appellee. There has never been any question of the right of the state commission to require appellant to report to it what its depreciation expense would amount to if figured at 3½ per cent upon all its property in the state, or upon any other basis.

Of course, any regulation of accounting which represents anything more than the shadow of authority will direct what accounting records are to be kept and how they shall be kept. It is as much concerned with forbidding as it is with directing. The normal objective is that the accounting company shall have a set of bookkeep-

ing records and that it shall be that prescribed, not that it shall have the prescribed record and also several other and different records of the same transactions. We have pointed out that the purpose of Congress in Section 20 of the Interstate Commerce Act to conform to this principle is clearly disclosed by authorizing the Interstate Commerce Commission to require the use of "a uniform system of accounts," to "prescribe the forms of any and all accounts, records, and memoranda," and by forbidding the keeping of any other accounts than those prescribed.

Reference is made by the Association in its brief, p. 9, to the requirements of the Federal Power Act. This would seem principally to serve the purpose of emphasizing the difference between what is there quoted and the provisions of the Interstate Commerce Act above referred to.

The reference in the same place to Section 220 of the Communications Act of 1934, so far from showing that "the powers of state commissions with respect to accounting have not been terminated," very clearly shows the intent of that act to continue in the new agency the same authority over the accounting of communications carriers formerly vested in the Interstate Commerce Commission.

There can be no doubt that Congress has authorized the federal Commission to prescribe the accounting of carriers subject to the Interstate Commerce Act. Congress intended that when such a system of accounting was prescribed, it, and no other, should be followed. The statute so provides. This Court upheld the statute and action taken under it in *Interstate Commerce Com-*

mission v. Goodrich Transit Co., 224 U. S. 194. Under our constitutional system this valid exercise of federal authority under the commerce clause has the effect which may flow from it both upon the carriers affected and upon the several state governments. This is because in case of conflict federal and not state rule is the supreme law of the land. The brief of the Association seems to rest upon the premise that exercise of federal authority under the commerce clause, otherwise valid, must yield to state authority to the extent it may conflict therewith. It is hardly necessary to say that the law is to the contrary.

It does not appear to be the argument of the Association that the state has power to regulate the accounting for intrastate business and the federal government has power over that for interstate business. Aside from the fact that in the telephone business the interstate and intrastate operations are inseparable, so that two sets of accounts become a practical impossibility, that constitutional question was disposed of in *Interstate Commerce Commission v. Goodrich Transit Co.*, supra. The argument here is that both governments have power to regulate the accounting for both types of business. See Association's brief, p. 31. That contention must at once be rejected, the federal authority having been exercised. The conflict inevitably attending any such anomalous program is noticed by the Association in the last recital of the resolution adopted by it and quoted on page 11 of its brief:

> "It is highly desirable that accounting regulations prescribed for the use of companies subject to the jurisdiction of both Federal and State authorities

> shall be prepared in cooperative conferences and shall be prescribed by both Federal and State authorities whenever that shall be possible, so that conflicting and diverse requirements may be avoided;"

What the Association and its counsel obscure is the principle that under our system there can be no such thing as conflicting requirements validly imposed by the state and federal governments.

THE JURISDICTION OF THE NEBRASKA COMMISSION TO MAKE THE ORDER IN QUESTION HAS BEEN DESTROYED BY THE EXERCISE OF PARAMOUNT FEDERAL AUTHORITY.

The proposition representing the contrary of the heading of this section of the brief constitutes the point to which most of the remainder of the Association's brief is directed. The argument of counsel for the Association to the effect that there has been no valid federal regulation of depreciation accounting requires for its completeness a premise which is left unstated by counsel. This premise is that the Interstate Commerce Commission had no authority over the depreciation accounting of telephone companies except as it was to be found in the amendment to Section 20, Paragraph 5 of the Interstate Commerce Act, which was made by the Transportation Act of 1920. See appellant's brief, p. 21. This amendment directed the Commission to prescribe the depreciation rates to be used by carriers in their accounting. It is argued that the Commission has not yet prescribed such rates, and therefore has exercised no lawful authority over depreciation accounting.

The difficulty of supplying this premise for the Association's argument is that it is wholly without foundation. The Interstate Commerce Commission long before the 1920 amendment had been clothed with authority to regulate the accounting of carriers subject to the Act. This included the authority to regulate depreciation accounting as fully as it included the authority to regulate the accounting for any other fact or transaction. The amendment of 1920 made it mandatory upon the Commission to prescribe the actual depreciation rates to be used in accounting. The Commission has never prescribed these rates, and except for the fact that the amendment requires it to establish classes of depreciable property, which has been done, we are not further concerned with the effect of this amendment in this case.

What the Interstate Commerce Commission has done, with respect to its presently applicable directions to carriers as to depreciation accounting, was done pursuant to the authority of the Interstate Commerce Act giving it power to prescribe a uniform system of accounts for telephone companies. It did not rest upon the authority of the amendment to Section 20, Paragraph 5, above referred to. As was necessary in order to establish a complete system, it prescribed the methods and principles which form the requirements of the system respecting the accounting for depreciation.

The Association characterizes this portion of the system of accounts as a "short cut" method of prescribing depreciation rates pursuant to the 1920 amendment. It is very apparent that it was nothing of the kind. The requirements of the system of accounts promulgated for

use on and after January 1, 1933, to which counsel for the Association takes exception, are not essentially different from the requirements which have been imposed on telephone companies ever since the Interstate Commerce Commission first prescribed a system of accounting for telephone companies effective January 1, 1913.* It will not do to become so far preoccupied with the activities of and proceedings had by the Interstate Commerce Commission in its endeavor to fix rates of depreciation pursuant to the amendment of 1920 as to lose sight of the complete authority to regulate depreciation accounting which long before that had been vested in and exercised by the Commission. It simply continued to exercise an authority over the depreciation accounting of telephone companies which it had possessed ever since they became subject to the Interstate Commerce Act.

We have already dealt in the appellant's brief with the considerations which we confidently urge as supporting the position that (a) the Federal Government has occupied the field of regulation of the accounting of carriers subject to the Interstate Commerce Act, and all state regulation of accounting is thereby precluded; and (b) independently of this, the requirements of the system

* The Uniform System of Accounts for Telephone Companies, First Issue, effective January 1, 1913, p. 67, provided:

"Telephone companies should include in operating expenses depreciation charges for the purpose of creating proper and adequate reserves to cover the expenses of depreciation currently accruing in the tangible fixed capital. * * *

"The amount charged as expense of depreciation should be based upon rules determined by the accounting company. Such rules may be derived from a consideration of the company's history and experience. Companies should be prepared to furnish the Commission, upon demand, the rules and a sworn statement of the facts, expert opinions, and estimates upon which they are based. * * *

"The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property."

of accounts as respects depreciation accounting make it impossible to comply with the order in question because they are in conflict with one another. It is not contended by the Association's counsel, as we understand it, that it is possible for appellant to obey a requirement of the system of accounts that it derive rates of depreciation according to the methods there prescribed and use them in its accounting, and at the same time obey the order of the Nebraska Commission. Of course, this is impossible.

What is argued on behalf of the Association is that the requirements of the system of accounts are ineffective because they leave it to the companies to make the estimates and calculations upon which the depreciation rates are to be based. We have already suggested the error which underlies the essential basis for this argument. It is the assumption that the direction to the companies contained in the system of accounts to estimate the service lives and salvage values upon which the rates depend is pursuant to the legislative direction to the Commission itself to prescribe depreciation rates. We have shown that this is not the basis of the directions in the system of accounts. Rather, such directions depend upon the authority given the Commission to regulate accounting. Of course, there is nothing novel in a system of accounts established by public authority which directs certain entries upon the books to be based upon calculations or estimates made by the accounting company. It is common knowledge that certain accounting entries must be founded upon a greater or less degree of estimate. The system of accounts, Exhibit 7 in this Record, contains a large number of instances independently of the regulations pertaining to depreciation accounting, where the

accounting company is directed to make entries based upon its estimates of one kind and another.*

Similar considerations seem to underlie the attempted distinction suggested on p. 32 of the Association's brief between prescribing the "rate of depreciation" and prescribing "the form of depreciation." Presumably counsel mean the form of depreciation accounting or of depreciation accounts. No such distinction in this connection is admissible. It may be repeated at this point that the whole concern with the matter of depreciation as we encounter it here is solely a matter of depreciation accounting. Whether the state governments or whether the Federal Government has power to determine or prescribe or establish rates of depreciation for any other purpose than directing that they be used in making accounting entries is a matter completely without interest in this case. The Interstate Commerce Commission did not establish rates of depreciation. It continued to do what it had done from the beginning of its exercise of authority over the accounting of telephone companies, and established the principles in accordance with which the expense of depreciation was to be calculated and esti-

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* Only the portions of the system of accounts relating to depreciation accounting are printed as part of the Record in this Court. The following references, among many others, to the system of accounts, Exhibit 7, illustrate the recognition throughout the system of accounts of the propriety of directing entries to be based upon estimates of the accounting company:

Instruction 20 (B). Property acquired for a consideration other than money to be entered in the appropriate plant account at a money value to be determined by the company.

Instruction 21 (B) (2). When telephone plant is purchased there is to be charged to the depreciable plant accounts "the current cost new (estimated if not known), of the property classable therein."

Instruction 25 (D). When telephone plant is retired, "When the actual book cost cannot be determined from the records, it shall be estimated."

Similar processes of estimation are required in connection with charges and credits on account of an insurance reserve carried by a self insurer and on account of a reserve for uncollectible accounts where such is maintained.

mated, and directed the companies to make such calculations and estimates and enter them upon their books. Whether state commissions may inquire and determine what the amount of depreciation expense of such company is for any purpose other than accounting, it is too plain for argument that it cannot do so for accounting purposes without invading the field which Congress and the Interstate Commerce Commission have occupied.

The distinction asserted between the "form" of depreciation accounting and its substance or content is a spurious one. A similar argument was made and overruled in *Kansas City Southern Ry. Co. v. United States*, 231 U. S. 423, where this Court said at pp. 440-441:

> "As to the intent and meaning of § 20, it is first insisted that the power conferred upon the Commission to prescribe the forms of accounts, records, and memoranda to be kept by the carriers, recognizes a distinction between the form and the substance; and that while the Commission, in order to obtain full and accurate information concerning the affairs of each corporation, must have power to require any reports, schedules, and accounts necessary to show the true financial condition of each carrier; yet that the grant must by fair interpretation, and in order not to amount to an unconstitutional delegation of legislative power, stop short of the point where the regulation in its essence goes not to the form but to the substance and involves interference with the internal affairs of the corporation. We do not, however, think that any such distinction between the form and the substance is admissible with respect to the declared object of standardizing railroad accounts and obtaining therefrom full and accurate information concerning the affairs of the respective corporations. The very object of a system of accounts is to display the pertinent financial operations

> of the company, and throw light upon its present condition. If they are to truly do this, the form must correspond with the substance. In order that accounts may be standardized, it is necessary that the accounts of the several carriers shall be arranged under like headings or titles; and it is obviously essential that charges and credits shall be allocated under the proper headings—the same with one carrier as with another."

The forms of accounts which Congress authorized the Commission to prescribe do not concern their typographical appearance upon the books of the company. They have to do essentially with what a given account shall embrace. As was said in the opinion just quoted from:

> "And since, as just shown, uniformity in accounting is dependent upon the adoption and enforcement of precise classification, the authority to define the terms of the classification necessarily follows." 231 U. S. at p. 443.

Counsel for the Association say, "The making of estimates of depreciation is not accounting" (p. 32 of Association's brief). Where the making of estimates of depreciation is done solely for the purpose of accounting, it is quite clear that the making of such estimates is a step in the process of accounting and nothing else. Where it happens that proper accounting in any field involves the making of estimates, it would seem self-evident that the public body having power to regulate such accounting has power to direct that the estimates be made and to determine in accordance with what principles they shall be made. The regulatory authority does not cease to function as such because it does not undertake to make the estimates itself.

It may be necessary to restate that the only concern with the order in question is with respect to its attempt to control the accounting of appellant. No objection is made to appellee Commission making "estimates of depreciation." So far as the making of such estimates is a process in itself, independent of accounting, we suppose no one would deny the right of either the Commission or the company to make any such estimates as may be of interest to either. Public regulation does not consist in making abstract determinations. It consists of directing the conduct of those subject to regulation.

Here the only effect of the state's authority has been to require the making of certain calculations and the entry of the resulting amounts upon appellant's books. This is the regulation of accounting. We have shown this to be beyond the state's power.

Even if there had somehow been saved to the states the authority to make the estimates of service lives and service values which are the criteria of annual depreciation charges as defined by the federal regulations, the Nebraska Commission has not pretended to make any such estimates.

It must be emphasized that nothing in the argument of appellant here implies lack of power in the state in a proceeding to fix charges for intrastate service to make its own determination of the expense of depreciation. It may be fully assumed for the purpose of this case that such power exists. No such considerations are here involved. The only effect of applying the order in suit would be to release to surplus, available for dividends or investment in plant, amounts now credited to the depreciation re-

serve account. The language quoted from *Lindheimer v. Illinois Bell Telephone Co.*, 292 U. S. 151, 167, on page 20 of the Association's brief, pertinent as there used by the court, is not applicable here. Subscribers are not in effect providing capital contributions unless the charges for service are in excess of just and reasonable charges. The earnings of appellant in Nebraska were at a level which precluded any suggestion that the depreciation expense charged upon appellant's books afforded any basis for undue exactions from its patrons (R. 83-84).

The character of the order as an accounting regulation without relationship to any proceeding for regulating the rates charged for service, was presented to the Commission, and the appreciation of it is evidenced by the following quotation from the dissenting opinion of Commissioner Drake:

> "I agree that if this were a rate case, instead of an accounting question, with the same facts presented, and presented in a properly conducted and concluded case, that I would probably agree as to the rate, but the present proceeding is not a rate case. If the order entered herein is valid, upon the same theories we can then issue an order which would set out the salaries which respondent could enter on its records as expense items for 1934. We do have the authority, in a rate case, to say what are reasonable items of expense for depreciation and for officers' salaries and other expenses, but I seriously doubt any jurisdiction to do so in an accounting investigation." (R. 40.)

THE REQUIREMENTS OF DUE PROCESS FORBID THE MAKING OF THIS ORDER BY THE NEBRASKA COMMISSION WITHOUT PREVIOUS NOTICE OR HEARING.

This question, of course, is not to be disposed of by a characterization of the order as "legislative in character." We regard it as legislative, in the sense that it prescribes a rule for future conduct rather than adjudges rights existing upon the basis of accomplished facts. In the same way an order of a regulatory body fixing charges for service is legislative in character, but we doubt that any one would argue that the Nebraska Commission could fix the rates of public utilities subject to its jurisdiction without notice or hearing, even apart from any statutory requirement in that regard.

The emphasis in our argument upon this question should remain upon the fact that the provision for a judicial review of the order in question is by an appeal and is limited to the record made before the Commission. In this fundamental respect this order differs from orders prescribing accounting which might be made by the Interstate Commerce Commission or other federal agencies referred to in the Association's brief. We are not concerned with the situation where the validity of accounting regulations could be attacked by injunction proceedings or other judicial means, and evidence there introduced by the carrier or other person affected. Compare the provisions of the Urgent Deficiencies Appropriations Act, U. S. C., Title 28, Sections 41 (28), 43-48.

Such cases as *State Corporation Commission v. Wichita Gas Co.*, 290 U. S. 561, are not pertinent in this connection. The appellant's claim that it was entitled to

notice and a full hearing before this order was made effective against it, does not rest alone upon the contention that it interferes unconstitutionally with appellant's property rights. Appellant contends that this order, if enforced, would require it, under the sanctions and penalties of state authority, to keep accounts in a manner forbidden under the sanctions and penalties of federal statutes. It urges that subjection to such oppressive and arbitrary requirements without notice and an opportunity for a full hearing thereon would deprive it of its liberty as well as of its property without due process of law.

Respectfully submitted,

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NEBRASKA STATE RAILWAY COMMISSION,
APPELLEE.

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Point 1. Due Process not violated since there was, in fact, full notice of the scope of the hearing and full opportunity to present evidence and argument, afford-